

**DISCRETIONARY ADJUSTMENTS TO OUTSTANDING AWARDS  
UNDER EQUITY COMPENSATION PLANS MAY CREATE  
ADDITIONAL COMPENSATION EXPENSE**

Major U.S. accounting firms have recently announced an interpretation of FAS 123(R) that would potentially require companies to take an additional compensation charge for antidilution adjustments made to outstanding awards under equity compensation plans. The plans of concern are those that provide for discretionary adjustment in connection with equity restructurings (e.g., stock splits, stock dividends, extraordinary cash dividends, spin-offs and recapitalizations).

Under FAS 123(R), any modification to the terms of an outstanding equity-based award requires the issuer to measure the fair value of the award after the modification. If the fair value of the modified award exceeds the fair value of the award at the time it was granted, the issuer is required to record an additional compensation expense equal to the excess.

In general, whether a particular adjustment will be treated as a modification for accounting purposes depends on whether the operative adjustment language is mandatory or discretionary. If an award is *required* to be equitably adjusted by the express terms of the plan, no modification will be considered to have occurred. This is apparently true even though determining the precise nature of the equitable adjustment requires the exercise of discretion. If, instead, the plan merely *permits* an equitable adjustment at the discretion of the company, the making of such an adjustment will be treated as a modification.

An amendment to add a mandatory adjustment feature will not result in an additional compensation expense, provided the amendment is not made in contemplation of an equity restructuring. Therefore, if your equity compensation plans do not currently require adjustments to awards in connection with equity restructurings, you should strongly consider amending them now, provided you are not currently contemplating an equity restructuring.

Equity plans sometimes deal with antidilution adjustments in the same section that deals with other permissible adjustments that may be appropriate in a business combination. Care should be taken to avoid creating enforceable contractual rights in cases where it is important to retain discretion.

Any amendments should be reviewed with your accountants, both to confirm that the change is *required* to avoid an accounting charge, for each type of adjustment that will be changed from permissive to mandatory, and to ensure that the proposed change will be effective for accounting purposes. You should also consult with legal counsel to confirm that any amendments are not broader than necessary and will not require shareholder approval. Neither the NYSE nor NASDAQ currently requires shareholder approval for such an amendment. Also, companies should consult with their tax advisors as to whether such an amendment would be considered a modification of outstanding awards for purposes of Section 409A of the Internal Revenue Code of 1986.

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If you wish to obtain additional information or need assistance in amending your equity compensation plans, please contact Frank A. Daniele (212-728-8216, fdaniele@willkie.com), Stephen T. Lindo (212-728-8242, slindo@willkie.com), J. Pasco Struhs (212-728-8109, pstruhs@willkie.com) or the partner who regularly works with you.

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